ANALYST WEEKLY

From AI rhetoric to reality

SEPTEMBER.11.2023

Summary

AI profits boom justifying the valuations

Artificial intelligence is moving from investment hope to reality, as a general-purpose technology with the fastest user adoption in history. We see three AI investment strategies: suppliers (like NVDA), enablers (like CAN), and users (like WMT). Semiconductor giant NVIDIA has led the way in the AI charge, with profits outlook surging 3x this year, cutting its valuation to 'only' 35x P/E. With S&P 500 valuations full the rally is all about the earnings rebound. @AI-Revolution. See Page 4

September starts with a slump

Tech stocks led markets down on headwinds of 4.3% 10-year bond yields and $90/bbl. oil, as US economy surprisingly strong and China stimulus continued. The S&P 500 fell below 50-day moving average, and BX and ABNB joined index. Poland first European country to cut interest rates. AAPL hit by China iPhone curbs. Weight-loss NVO now Europe's largest stock. See Q3 Markets Outlook HERE and at twitter @laidler_ben. See Page 2

US growth is as good as it can get

Q3 GDP growth is tracking highs not seen in 40-yrs ex-pandemic. A inevitable 'soft landing' slow down should take sting out of bond yields and help long duration assets like tech. See Page 2

Why interest rates aren't working yet

The US a global outlier with its high level of fixed interest rate and long maturity corporate and consumer debts. Only delays impact of Fed's interest rate upcycle on economy. See Page 2

The twin threat from higher oil prices

It's $100bn US consumer tax and raising inflation fears but will self-correct as triggers slowdown fears. US gas prices exacerbated by its low taxes, car inefficiency, and huge mileage. See Page 2

Space is booming but difficult

Objects launched soaring on flywheel of lower costs and miniaturisation. Investable universe broadening from rockets to imaging even as space ETFs serial underperformers. See Page 2

Easier for companies to own crypto

Crypto stabilises, even as trading volumes and VC funding now at multi-year lows. Better news from the US accounting standards board making easier for companies to own crypto, ARK and Van Eck filing to launch spot Ethereum ETF, and UK FCA pushing back tougher marketing rules. See latest Weekly Crypto Roundup. See Page 3

Oil hits year-to-date high over $90 per barrel

Oil rally offsets the stronger dollar and global growth fears. Brent was boosted by Russia/Saudi extending production cuts, China stimulus, and inventory falls. Ag markets disrupted by supply concern and El Nino. OJ hits high on Brazil citrus disease. Lithium consolidation builds with ALB 100% premium bid for LTR.AX. See Page 3

The week ahead: Inflation, Apple, ARM

1) US inflation (Wed) most important number in markets. 2) AAPL iPhone 15 launch (Tue) and ARM biggest IPO of year (Thu). 3) Big tech ADBE and ORCL earnings plus Zara owner ITC.MC, CPRT, LEN. 4) Friday is 'triple-witching' high volume futures and options expiry. See Page 3

Our key views: A positive markets breather

Market seeing breather after strong 1H, with weaker seasonality, low volatility, and coming growth slowdown. But fundamentally positive on lower inflation and coming rate cuts. Focus on defensive growth and long duration assets from healthcare to big tech. Cautious growth exposed cyclicals, commodities, and banks. See Page 5

Top Index Performance

	1 Week	1 Month	YTD
DJ30	-0.75%	-2.00%	4.31%
SPX500	-1.29%	-0.15%	16.10%
NASDAQ	-1.93%	0.86%	31.48%
UK100	0.18%	-0.61%	0.35%
GER40	-0.63%	-0.58%	13.05%
JPN225	-0.32%	0.41%	24.96%
HKG50	-0.98%	-4.58%	-7.98%

*Data accurate as of 12/09/2023

Market Views

September starts with a slump

- Tech stocks led markets lower on twin headwinds of 4.3% 10-yr bond yields and $90/bbl. oil, as US economy surprisingly strong and China stimulus continues. S&P 500 falls below 50-day moving average, and BX and ABNB join index. Poland first European country to cut interest rates. AAPL hit by China iPhone curbs. Weight-loss NVO now Europe's largest stock. **See NEW Q3 Outlook HERE**. See Page 6 for resources and videos.

US growth is as good as it gets

- US GDP near unprecedented 5.6% growth this quarter per Atlanta Fed NOWCast. This over-estimates growth more than usual but would be the highest since 1984 if realised, outside of the pandemic. It's a long way from feared recession,

- It's also peak growth. The US has been firing on three of four cylinders. Consumption, investment, and government spending have offset weaker trade, but are all set to ease. A soft landing is the base case, and slower growth should take sting out of bond yields and favour long duration assets like tech vs cyclicals and Value. **See Page 2**

Why interest rate hikes aren't working yet

- US economic growth has continued to be a big positive surprise. Whilst core inflation has been sticky. Despite one of the shortest and sharpest interest rate hiking cycles in history. Economist Milton Friedman wrote about these 'long and variable lags' in transmitting higher interest rates to a slower economy back in 1982. His study of 18 business cycles over a century showed a wide transmission lag of between 4 and 22 months.

- We are 18 months from the first March 2022 Fed interest rate hike. Two issues delaying the transmission, where the US is a global outlier, are 1) a high proportion of fixed rate debt and 2) long maturities. This delays, but not postpones, the coming economic growth slowdown. **See Page 2**

The twin threat from higher oil prices

- Brent oil hit $90/bbl. for first time this year as top OPEC+ producers, Russia and Saudi, extended supply cuts until year end. Higher oil prices are a short-term double-threat to markets, as a $100 billion US consumer tax and is already pushing up inflation expectations and likely worrying the Fed.

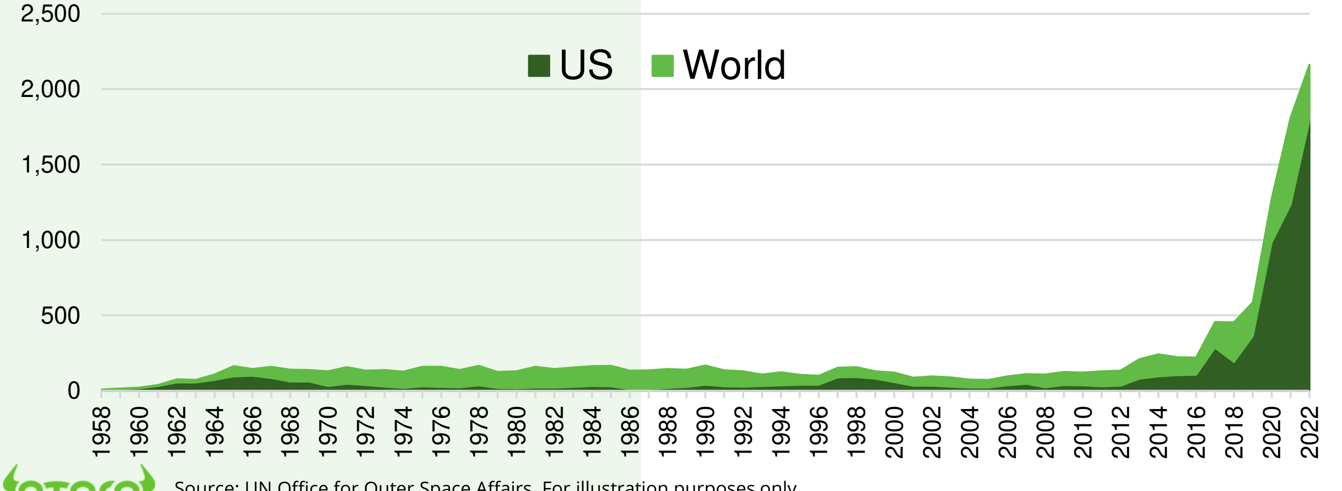
- This is a recipe for short term market volatility, but we see it as ultimately self-correcting. As further oil price rises would trigger inflation, interest rate and growth slowdown fears. US gasoline prices are 23% off their recent lows, with impacts exacerbated by the US's very low gas taxes, relative car inefficiency, and mileage double European average. **See Page 2**

Space is booming but difficult

- The space market is soaring but space stocks not. The objects launched has quadrupled in four years and SpaceX's $140bn private-market valuation now bigger than Boeing (BA) or Lockheed Martin (LMT).

- But investing in the young, inherently risky, capital-intensive space industry is difficult. All related ETFs under-performed S&P 500 the past five years. But the investable universe is expanding, from rockets to satellites, imagery and data, and its innovations find way into earth-bound products. **See Page 2**

Number of objects launched into space (by year)



Source: UN Office for Outer Space Affairs. For illustration purposes only

Market Views

Easier for companies to own crypto

- Crypto markets were resilient to weaker global asset markets. Came even as trading volumes hit a 4.5 year low, and venture capital funding activity has now fallen to under $300 million a month from the 2020 peak of over $7 billion.

- The US accounting standards board voted to make it easier for companies to hold crypto assets. Whilst ARK and Van Eck both filed spot Ethereum ETF applications with the SEC.

- Regulatory news saw the IMF and FSB come out against blanket crypto bans, and the UK regulator delay its new tougher crypto marketing rules. See the latest Weekly Crypto Roundup.

Oil hits year-to-date high over $90 per barrel

- Commodity markets supported by Brent oil hitting $90/bbl., a YTD high, and offsetting the stronger dollar and global growth concerns.

- Top-2 oil exporters Russia and Saudi extended voluntary production cuts until year-end. Whilst biggest importer China latest purchases soared, and it continues it's drip-feed of macro stimulus. And as oil inventory levels continue to fall.

- Agricultural markets were hit by supply concerns and El Nino weather disruption. Orange Juice prices hit new highs on citrus disease risk in the largest producer, Brazil.

- Lithium consolidation builds as ALB buys LTR.AX.

US Equity Sectors, Themes, Crypto assets

	1 Week	1 Month	YTD
IT	-1.67%	2.81%	40.74%
Healthcare	-1.32%	-2.07%	-2.46%
C Cyclicals	-0.96%	-2.06%	25.70%
Small Caps	-3.61%	-4.10%	5.13%
Value	-1.15%	-1.85%	0.42%
Bitcoin	0.77%	-12.42%	56.12%
Ethereum	0.83%	-11.88%	36.34%

Source: Refinitiv, MSCI, FTSE Russell

The week ahead: Inflation, Apple, ARM, Witching

1. A big macro week with August US **inflation**, the most important number in markets. See a mixed message of rising headline inflation, but cooling core. Also retail sales and a likely **ECB** rate pause.

2. World's largest stock, **AAPL**, has iPhone 15 launch (Tue) in hoped reboot to weak global smartphone market. Comes ahead of biggest IPO of the year with processor chip leader **ARM** re-listing (Thu).

3. A slew of important **earnings** from big tech ADBE, and ORCL, and consumer bell weathers Zara-owner ITX.MC, CASY, CPRT, and homebuilder LEN. Ahead of October 13 start of Q3 earnings season.

4. '**Triple-witching**' US future and option expiry (Fri), one of most heavily-traded days of year. Could add to volatility. **UAW** US auto workers contract expires (Thu) impact from F to GM and STLAM.MI.

Our key views: A positive markets breather

- Markets see a breather after very strong 1H, with weaker summer seasonality, too low volatility, and the still-coming GDP growth slowdown. But are fundamentally positive markets, with a stronger Q4 and 2024, as economies avoid recession, with lower inflation and coming interest rate cuts.

- Faster slowdown hurts earnings. But lower bond yields helps valuation. Focus on defensive growth and long duration assets, from healthcare to big tech. More cautious on assets most exposed to recession risk, like cyclicals, small caps, and commodities. Or with lower yields, like banks.

Fixed Income, Commodities, Currencies

	1 Week	1 Month	YTD
Commod*	-0.60%	0.47%	-5.96%
Brent Oil	1.63%	4.28%	5.18%
Gold Spot	-1.20%	-0.16%	6.15%
DXY USD	0.79%	2.15%	1.48%
EUR/USD	-0.70%	-2.25%	-0.01%
US 10Y Yld*	8.53	11.69	39.15
VIX Vol.	5.73%	-6.74%	-36.13%

Source: Refinitiv. * Broad Bloomberg index. * Basis points

Focus of Week: AI rhetoric to reality

Artificial intelligence is now moving from investment hope to reality

AI has seen the fastest user adoption of any technology in history. This general-purpose tech has broad and accelerating use cases and investment. Rhetoric has quickly moved to implementation reality. Early profits growth has justified NVIDIA's first-mover valuations. And is being led by some of the largest and most profitable companies. These are both clear contrasts to the 2000 internet bubble. @AI-Revolution.

Building and spreading AI momentum

It's early days. Most companies are testing AI use cases and investing ahead of potential growth. A third of S&P 500 stocks mentioned AI on their latest conference calls. First mover NVIDIA (NVDA) is seeing 170% sales growth this quarter. OpenAI ChatGPT operator, part owned by Microsoft (MSFT), is tracking $1 billion of revenue. It's not just the US, with China's Baidu (BIDU) to Tencent (0700.HK) rolling out AI tools. Many will disappoint. C3.ai (AI) was the latest to sell off as upfront costs disappointed investors high expectations.

We see three AI investment strategies – suppliers, enablers, and users

We see three winning segments form AI adoption. 1) Suppliers of hardware. Like mass-data storage Seagate (STX), chip foundry TSMC (TSM.US), and lithography leader ASML (ASML). 2) Consultants helping companies get the best from AI. Like Accenture (ACN), IBM (IBM), and SAP (SAP). 3) Efficiency winners, like Walmart (WMT), with its massive workforce and supply chain, or early adopter BT Group (BT.L).

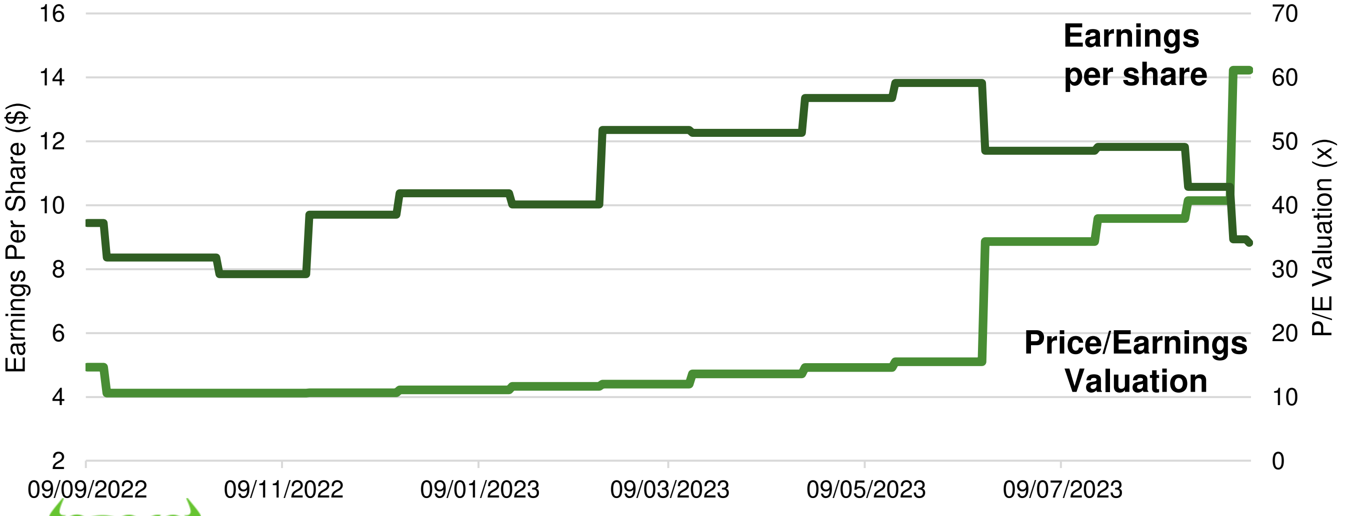
Semiconductor giant NVIDIA has led the way in the AI charge

This 'picks-and-shovel' supplier to the AI boom has the first mover tech and seeing pricing power. This will inevitably ease but is driving huge earnings growth. This justifies the 230% share price rally this year. Its earnings outlook has seen its forward P/E ratio fall from 85x to 35x as profits forecasts tripled (see chart).

It's all about earnings from here

Valuations have led the US market rally this year. Now earnings need to catch up and drive the next stage. The AI tech boom is one of the three legs to this recovery. Tech is the biggest sector in stock markets and is seeing some of the strongest profits growth already. AI optimism and cost cuts are a big driver of this, alongside the lower inflation relief to profit margins, and the more resilient-than-expected GDP growth.

NVIDIA prospective earnings vs P/E valuation (last 1-Year)



Source: Refinitiv. For illustration purposes only.

Key Views

The eToro Market Strategy View

Global Overview	Aggressive and extended Fed interest rate hiking cycle and stubborn inflation accelerated our 2023 view. Of a coming GDP slowdown, but not recession, plus lower inflation, and a peaking Fed interest rate cycle. Will pressure earnings but also lower bond yields and take pressure off de-rated valuations. We are invested, believing Oct 2022 was the low, and focus on cheap and defensive assets for a faster 'V-shaped' market recovery. **See our Q3 Outlook** HERE

Traffic lights*	Equity Market Outlook
United States	World's largest equity market (60% of total) seeing slowing but resilient GDP and earnings growth. Valuations led the rebound this year and are supported high company profitability and peaked bond yields. Focus on cash-flows defensives, like healthcare and high dividend. And Big-tech supported by defensive growth, cost cutting, and AI. See gradual 'U-shaped' rebound as inflation slowly falls and de-risks market and boosts tech and crypto appetite.
Europe & UK	Favour defensive and cheap UK ('Economies not stock-markets') and continental European equities. Recession risk easing with lower natgas prices and reopening China with high 'buffers' of rising fiscal spending (defence and refugees) and weak Euro (50%+ sales overseas). Even as ECB hikes aggressively. Equities cushioned by lack of big tech sector and 30% cheaper valuations vs US. Banks better capitalised and regulated but loans/GDP much higher.
Emerging Markets (EM)	China, Korea, Taiwan dominate EM (60% wt.), and more tech-centric than US. Positive China as economy reopens, supports property sector, eases tech regulation pressure. Valuations 30% cheaper than US and markets out of favour. Recovery helps global sectors from luxury to materials. EM needs weaker USD and peak US rates catalyst.
Other International (JP, AUS, CN)	Canada and Australia have benefitted from strong equity market weight in commodities and financials, as global growth resilient and bond yields risen. Now could be becoming headwinds. Japanese equities among worlds cheapest with own and China-proxy growth and governance improving but threats of tighter monetary policy and stronger Yen.

Traffic lights*	Equity Sector & Themes Outlook
Tech	'Tech' sectors of IT, communications, consumer discretionary (Amazon, Tesla), dominate US and China. Expect better performance as 1) lower bond yields take pressure off valuations and 2) high profit margins and fortress balance sheets make defensive to recession risks. 2) Cost cuts and AI add to growth. 'Disruptive' tech much more vulnerable.
Defensives	More attractive as recession risks rising and bond yields have peaked. Consumer staples, utilities, (some) real estate attractive with defensive cash flows, less exposed to rising economic growth risks, and with robust dividends. Healthcare is the most attractive, with cheaper valuations, more growth, some rising cost protection.
Cyclicals	High risk cyclical sectors - like discretionary (autos, apparel, restaurants), industrials, energy, materials, and small caps - have cheap valuations, many with depressed earnings, and have been out-of-favour for many years. But they are significantly exposed to rising recession risks. Some especially cheap (energy) or see growth recovery (airlines).
Financials	Current stresses likely individual not systemic. Post GFC reforms boosted capital and size/speed of authority's response. But outlook for 1) less GDP growth, 2) lower bond yields and interest rates, and 3) valuation sensitivity after recent surprises, worsens outlook. Insurance and Diversifieds (like Berkshire Hathaway) more defensive.
Themes	Dividends and buyback themes attractive with resilient cash flows, rising pay-outs, and investor search for defensives. Power of compounding dividends under-estimated, at up to 1/2 of total long-term return. Small caps pressured by rising recession risk. Secular growth of Renewables and Disruptive Tech investment themes.

Traffic lights*	Other Assets
Currencies	USD 'wrecking ball' driven by Fed interest rates and 'safer-haven' bid. DM currencies hurt by still low interest rates and struggling growth. Strong USD hurt EM, commodities, US foreign earners like tech. But helps big EU and Japan exporters. See a stabler USD outlook in 2023 as near top of the Fed cycle and global risks remain high.
Fixed Income	US 10-yr bond yields supported around 4% by higher Fed rate hike and stickier inflation expectations. Set to ease as recession risks slowly build and inflation expectations gradually fall. US has widespread to other market bond yields, and headwinds of high debt, poor demographics, and low productivity. 5% bill yields an attractive cash alternative.
Commodities	Strong USD and rising recession fears hit commodities. But still above average prices helped by GDP growth, 'green' industry demand, supply under-investment, recovering China, Russia supply crisis. Oil helped by slow return of OPEC+. But commodities not to repeat their 2021 and 2022 performance leadership. Gold benefits from safer haven demand.
Crypto	Potential 'surpsise' after dramatic and early asset class sell-off and later specific risk events from Luna to FTX. See long term asset class development with small size $1 trillion, correlations low, regulation growing, development/catalysts continuing – Ethereum merge to proof-of-stake and coming BTC halving.

*Methodology:	Our guide to where we see better risk-adjusted outlook. Not investment advice.
Positive	Overall positive view and expected to outperform the asset class on a 12-month view.
Neutral	Overall neutral view, with elements of strength and weakness on a 12-month view.
Cautious	Overall cautious view, and expected to underperform the asset class on a 12-month view.

Source: eToro

Analyst Team

Global Analyst Team			
CIO	Gil Shapira	**Italy**	Gabriel Debach
Global Markets	Ben Laidler	**Holland**	Jean-Paul van Oudheusden
United States	Callie Cox Bret Kenwell	**Iberia/LatAm**	Javier Molina
		Nordics	Jakob Westh Christensen
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